MINISTRY OF ENERGY, MINES AND PETROLEUM RESOURCES

BRITISH COLUMBIA NATURAL GAS

CORE MARKET POLICY

JUNE 1988

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1. INTRODUCTION

The October 31, 1985, "Agreement Among the Governments of Canada, Alberta, British Columbia and Saskatchewan on Natural Gas Markets and Prices," outlined a plan for the gradual deregulation of natural gas markets in Canada. It identified the following five major objectives:

- maintain industrial competitiveness;
- enhance market access to Canadian natural gas producers and consumers;
- foster competition;
- maintain secure future supplies for Canadian consumers; and
- maintain the sanctity of existing contracts.

Since October 31, 1985, much effort has been spent in various jurisdictions toward establishing policies that balance all five objectives. The results have varied depending on the circumstances in each jurisdiction and the weighting placed on each objective. This paper presents a policy outlining which consumers must be protected from future supply disruptions by long-term contracts for natural gas.

2. CONSTRAINTS TO OPEN ACCESS

In an ideal world, an open access policy would allow all natural gas consumers to make their own natural gas supply arrangements. Competitive forces would lead to an efficient allocation of resources. However, constraints and imperfections exist in the market which create a need for certain consumers, for whom a secure supply of natural gas at stable prices is essential, to continue to be protected now by long-term contracts from future supply exigencies. These consumers comprise the "core market." The following factors were recognized in identifying which consumers are to be included in this category.

2.1 Security of Supply

Natural gas consumers with consistent, large energy requirements and/or the ability to use alternative fuels, as in the case of many large industrial users, are in a good position to arrange secure, least cost energy supplies. Other consumers, in the residential, commercial and institutional markets, use natural gas primarily for space heating. They have a great need for security of supply, and have highly variable daily

and seasonal volume requirements. Unless these consumers have alternative energy supplies, they must be assured of reliable, long-term supplies of natural gas.

2.2 Delivery Constraints

During periods of rapidly increasing demand for natural gas, constraints in the production and delivery of natural gas may limit its availability even though reserves are proven. The consumer most vulnerable to the resulting supply interruptions and price escalations is the one who depends on a single supplier with whom he has a direct agreement, rather than on a utility with a portfolio of supplies. In a situation where a customer's private supply of gas fails, one would expect pressure on the government and the local utility company to make supplies of natural gas available to that consumer, particularly if he is in the residential, institutional or commercial sector and totally reliant on natural gas for space heating.

2.3 Business Incentives

The right to contract natural gas directly, and obtain it at least cost, influences high energy use industries in decisions on location of their operations. The British Columbia government has recognized this fact and has stated on several occasions that the abundance of energy in the Province should be used to assist industrial growth.

2.4 Administrative Costs

There would be a number of additional administrative costs to the distribution utilities if a large number of natural gas purchasers chose to make their own natural gas supply arrangements. These costs would result from a substantial increase in work related to load management and from decreased economies of scale as the utilities' contract volumes were reduced. As a result, the administrative cost per unit of natural gas under contract would increase as the volume under contract decreased.

3. OBJECTIVES OF THE POLICY

Recognizing the Province's commitment to deregulation and considering the foregoing constraints, the policy objectives are:

- to ensure a long-term secure supply of natural gas at reasonable prices to a defined core market; and
- to provide sufficient incentives to businesses to locate in British Columbia.

4. DEFINITIONS

4.1 Core Market

The British Columbia core natural gas market includes those categories of natural gas consumer for whom the protection of long-term supply contracts is essential. Generally, they are consumers who have no ability to use alternative energy sources, use natural gas primarily for space heating, take relatively small volumes and have a high security requirement. In short, they are customers whose requirements must be protected from supply disruptions and sudden price escalation.

The initial core market includes all residential, institutional, commercial and industrial customers who are not currently purchasing natural gas directly. These consumers are presumed to remain in the core market unless they can demonstrate, to the satisfaction of the B.C. Utilities Commission (BCUC), that they have adequate natural gas supplies and/or alternative energy supplies under direct purchase contracts to guarantee their long-term security.

4.2 Non-Core Market

The balance of the British Columbia market consists of consumers who, by virtue of their size and volume requirements, are capable of participating in the wholesale natural gas market as sophisticated purchasers procuring natural gas supplies in accordance with their business requirements, are producers of natural gas for their own use or are able to suffer a shutdown or to use alternative energy supplies in the event of a supply failure.

Non-core market consumers are generally large industrial customers such as pulp mills, chemical plants, smelters and refineries, many of whom already contract directly for natural gas supplies. Large industrials are considered to be non-core so long as they elect to make their own natural gas supply arrangements and can demonstrate, to the satisfaction of the BCUC, sufficient natural gas supply security and/or alternative fuel capability to ensure security of the industry.

Small industrial, commercial and institutional consumers wishing to leave the core market will be required to demonstrate to the BCUC that their natural gas supply arrangements are sufficient to meet their greater security requirements.

5. OPTIONS AND RESPONSIBILITIES

5.1 Core Market

Core market customers will continue to be supplied by the distribution utilities; they may not contract directly for natural gas. The utility is responsible for maintaining a portfolio or pooled natural gas supply having sufficient characteristics of term, deliverability and supply security for its core customers' needs.

The BCUC will continue to ensure that natural gas purchases by the utilities are prudent and that rates to customers are fair.

5.2 Non-Core Market

Non-core consumers will contract for their own natural gas supplies in accordance with their own business judgement with minimal government restriction. They are allowed full and open access to the competitive natural gas market. The BCUC will review non-core customers' new natural gas supply arrangements to insure that adequate supplies are under contract. Direct natural gas sales are already allowed, and the distribution utilities provide contract transportation services for such customers.

6. EXEMPTION FROM CORE MARKET

As the body with the primary jurisdiction over utilities, the BCUC will have the discretionary ability to determine whether a core market customer may leave, or rejoin, the core market. A natural gas customer or group of customers who wishes to leave the core market must demonstrate to the BCUC adequate supply and deliverability of natural gas over a sufficiently long term, or adequate alternative energy supply and the ability to switch to it on relatively short notice to ensure that it is not vulnerable to natural gas supply interruptions or rapid price increases.

If becoming or ceasing to be a utility customer imposes costs on the utility, the BCUC will decide whether the costs are to be borne by the customer responsible. In the past, the BCUC has allowed conditional passthrough of related costs when one customer's actions have affected other customers.

7. TRANSPORTATION TO NON-CORE CUSTOMERS

In order to make a direct sale, transportation as well as natural gas supply must be arranged. Transportation service is required on both the transmission company's system and the distributors' systems.

Availability of service varies from one pipeline system to another. Service is available on the Westcoast Energy Inc. transmission system. On the Inland Natural Gas Co. Ltd. distribution system, transportation is available to large industrials to fit a broad range of circumstances.

Transportation service is currently available on the Pacific Northern Gas Ltd. system on a negotiated basis. B.C. Hydro and Power Authority's Natural Gas Division has transportation service available to its large industrial customers on an interruptible basis. Transportation is not currently available to small industrials on B.C. Hydro's system.

8. OTHER CANADIAN MARKETS

There has been much discussion at public hearings throughout Canada of how best to settle the issue of access to core markets. The Governments of Ontario and Quebec generally support the principle of making direct sales of natural gas available to all consumers. The Government of Alberta strongly supports the sanctity of existing supply arrangements and opposes efforts by consuming provinces to make direct sales of natural gas available to core markets. Alberta applies restrictions in removal permits on sales to core market customers outside Alberta.

It is not the British Columbia government's intention to apply its domestic core market policy outside the Province. It is assumed the regulatory body in the receiving jurisdiction has assessed its own risks of lack of security of supply in development of its core market policy. British Columbia will continue to respect the sanctity of existing contracts.

While British Columbia has abundant supplies of natural gas, constraints on the pipeline systems carrying British Columbia natural gas to Canadian customers generally limit the availability of firm transportation service.

Therefore, if British Columbia natural gas is only available on an interruptible basis under a particular contract, the Province must be satisfied that the end-use natural gas customers in Canada have been notified of that fact before a natural gas removal will be approved.

9. CONCLUSION

The present market situation of an ample surplus of natural gas could change as exports and production expand; therefore, the Government of British Columbia believes that responsible deregulation includes protection of a core market for which long-term security of supply is essential. By defining the core market, the participants in the natural gas industry will have a clear picture of their options and responsibilities so that contracting can proceed in an orderly way.

10. SUMMARY

- The core market is defined as all natural gas consumers in the residential, institutional, commercial and industrial sector not currently purchasing natural gas directly and not exempted from the core market by the BCUC. The intent is to include all customers who must be protected by contracts which ensure long-term security of supply and stable prices.

- Core market customers are excluded from direct natural gas purchase; distribution utilities will continue to serve the core market.

- A customer may apply to the BCUC to leave the core market. The BCUC would only approve such an application if the customer clearly demonstrates he has adequate long-term natural gas supplies or alternative fuel supplies to protect him from supply interruptions.

- The non-core market is defined as all large industrial customers who elect to make their own natural gas supply arrangements, and who can demonstrate to the BCUC sufficient long-term natural gas supply protection or alternative fuel capability to ensure security of the industry, and any other customer who is exempted from the core market by the BCUC.

- Non-core market customers have full and open access to the competitive natural gas market.

- The British Columbia government will not apply its core market policy to other jurisdictions through Energy Removal Certificates. Sanctity of existing contracts will be respected. End-use customers in Canada must be notified in advance if British Columbia natural gas is interruptible.

Energy Policy Branch
Ministry of Energy, Mines
and Petroleum Resources

June 15, 1988

B.C. UTILITIES COMMISSION
ENERGY SUPPLY CONTRACTS - RULES

The following rules have been developed to facilitate the review by the Commission of energy supply contracts pursuant to Section 85.3 of the Utilities Commission Act. The review is to ensure that the terms of the contract are in the public interest having regard to the following:

(a) the quantity of the energy to be supplied under the contract,

(b) the availability of supplies of the energy referred to in paragraph (a),

(c) the price and availability of any other form of energy, including but not limited to petroleum products, coal or biomass, that could be used instead of the energy referred to in paragraph (a),

(d) in the case only of an energy supply contract that is entered into by a public utility, the price of the energy referred to in paragraph (a), or

(e) any other factor that the Commission considers relevant to the public interest.

NATURAL GAS SUPPLY CONTRACTS

In the case of natural gas supply contracts, the review is also to ensure the availability of long-term supplies of natural gas at reasonable prices for the core market in keeping with the "British Columbia Natural Gas Core Market Policy".

1.0 GENERAL RULES FOR ALL NATURAL GAS CONTRACT CLASSES

1.1 Under Section 85.3(1)(a), all natural gas purchasers in British Columbia, other than those purchasing exclusively from a gas utility, must file their supply contracts and all subsequent amendments with the Commission and obtain approval where necessary before delivery of natural gas occurs.

1.2 A gas supply contract or other information filed with the Commission under Section 85.3 will be kept confidential except where the Commission considers that disclosure is in the public interest.

1.3 The reserves and deliverability of all gas supply contracts requiring approval will be reviewed by the Petroleum Engineering and Operations Branch of the Ministry of Energy, Mines and Petroleum Resources. The initial pre-approval review will be followed up with annual reviews for the life of the contract.

The review process and acceptance criteria will be identical to those applicable to long-term energy removal certificates ("ERCs"). This will be based on a flexible reserve dedication policy including provision for corporate pooling and warranties. The existence of a recent supply evaluation for ERC purposes would preclude the need for further review. An information package on the review process is available from either the Commission or the Ministry.

1.4 The Commission will issue Orders approving all gas supply contracts except those for category 2.1 which do not require approval. Notwithstanding Commission approval, customers who contract for direct purchase of their natural gas supplies do so at their own risk of availability and market prices.

1.5 Purchasers who wish to displace direct purchases with utility purchases will be accommodated providing the utility can contract sufficient gas to meet the additional load and providing the Commission is satisfied that there will be no resulting long-term negative impact on supply and price for existing utility customers. The Commission will normally allow utilities to require up to 13 months' notice to accommodate such load increases.

1.6 Notwithstanding 1.1 above, purchasers who have satisfied Commission requirements for long-term supply security as per Section 2.0 below and who wish to operate in the "spot" market will be permitted to make special arrangements with the Commission to facilitate timely approvals. Generally, this will consist of notification in advance of gas flow followed by filing of an executed contract as soon as possible thereafter.

1.7 It is the intention of the Commission to review and approve contracts expeditiously, normally without the requirement for a hearing. It is also the Commission's intention to avoid retroactive Orders. The hearing process, pursuant to Section 85.3(2) of the Act, may become necessary where the Commission and the purchaser cannot agree on the contents of a contract. A hearing could also arise as a result of a third-party complaint.

1.8 Recognizing both the current changing market environment and that a variety of contracts between producers and purchasers may be nearing expiry, or at the final stages of negotiations, the Commission will consider some phase-in of these revised Rules. Also, the Commission may reconsider the duration of energy supply commitments required by Section 2.0 as gas supply market conditions change. Any change would be prospective and it is the Commission's intent that parties honour existing contracts in all cases.

2.0 ADDITIONAL SPECIFIC RULES BY NATURAL GAS CONTRACT CLASS

2.1 Industrial Purchasers with Short-Term Natural Gas Supply Contracts

Industrial purchasers entering into contracts with a term of two years or less are required to file the following information with the Commission:

2.1.1 a copy of the gas supply contracts (excepting price information);

2.1.2 a description of the source of supply listing well locations and field names by producing company; and

2.1.3 written confirmation acceptable to the Commission that the purchaser's energy supply capability is such that they can maintain normal operations without returning to the utility for supply of natural gas for a period of up to 13 months as may be required by 1.5 above.

2.2 Industrial Purchasers with Long-Term Natural Gas Supply Contracts

Industrial purchasers entering into contracts which specify a term of more than two years, either directly or as a result of "evergreen" provisions, will be required to submit their gas supply contracts (excepting price information) to the Commission for approval, together with all other related contracts which support the gas supply and any information required by 1.3 above. In combination, each purchaser's portfolio of gas supply contracts (long-term, short-term and spot) should provide for:

2.2.1 a supply commitment sufficient to meet the purchaser's peak-day firm requirements in the current year for the duration of the contract as per 1.3 above; and

2.2.2 diversity of supply including where possible a range of suppliers positioned behind alternative processing facilities, or backstopping.

2.3 Other Purchasers

Commercial purchasers, institutional purchasers (such as hospitals and schools), municipalities, co-ops, associations, and any other purchasers who wish to contract for direct sales must submit gas supply contracts (excepting price information) to the Commission for approval, together with all other related contracts which support the gas supply and any information required by 1.3 above. In combination, each purchaser's portfolio of gas supply contracts (long-term, short-term and spot) should provide for:

2.3.1 a rolling 5-15 year supply commitment sufficient to meet the purchaser's peak-day requirements in the current year as per 1.3 above (5 years for loads equivalent to industrial, 15 years for loads equivalent to residential); and

2.3.2 diversity of supply including where possible a range of suppliers positioned behind alternative processing facilities, or backstopping arrangements.

2.4 Utilities

Utilities must submit their gas supply contracts to the Commission for approval, together with all other related contracts which support the gas supply and any information required by 1.3 above. In combination, each utility's portfolio of gas supply contracts (long-term, short-term and spot) should provide for:

2.4.1 a rolling 10-15 year supply commitment based on peak day firm load in the current year as per 1.3 above (if the utility has a high proportion of industrial load this figure may be reduced accordingly);

2.4.2 diversity of supply including where possible a range of suppliers positioned behind alternative processing facilities, or backstopping arrangements; and

2.4.3 a prudent combination of terms, conditions, and price.

Further to 1.8 above, the Commission will conduct periodic reviews of the utility's supply arrangements to ensure the development of a prudent balanced portfolio.

Province of British Columbia
Ministry of Energy, Mines
and Petroleum Resources

INFORMATION LETTER

E92-17

ENERGY RESOURCES DIVISION

SUBJECT: CORE MARKET POLICY REVIEW

The ministry introduced the natural gas Core Market Policy ("the Policy") in 1988. The purpose of this Information Letter is to request comments on this Policy, in particular whether it continues to be appropriate given the evolution of gas markets over the past four years.

The Policy sets a very broad framework for core market gas supply requirements and, given its general nature, major changes to the Policy are not expected to be required. However, full weight will be given to all comments and suggestions from interested parties.

The B.C. Utilities Commission ("BCUC") implements the Policy through its Energy Supply Contract Rules ("the Rules"). The BCUC is planning to hold a public review of its Rules in the Fall of 1992. The ministry will publish the revised Policy in August 1992, prior to the BCUC review. To assist the BCUC in determining the scope of its review, interested parties are encouraged to provide comments concurrent with this review as to how any proposed changes in the Policy might be reflected in the Rules. These comments should be directed to the BCUC.

Attached are the Policy, the Rules and a Backgrounder, which outlines the Policy's key aspects.

The ministry suggests that parties interested in commenting on the Policy may wish to address the following questions.

1) Benefits of a Core Market Policy - The Policy has provided a stable environment for the transition to more deregulated natural gas markets. To what degree do gas markets need continued government regulation of contracting requirements, and what form should such regulation take?

2) Policy Objectives - Are the objectives of the Policy as outlined in Point 3 of the Policy still relevant? If not, what objectives should be the focus of the revised Policy?

3) Security Issues - Are the security of supply issues, as explained in Part 2.1, still consistent with today's gas markets and contracting practices? If not, what are the current security of supply concerns and how may these be best addressed?

4) Core Market Definition - The core market is currently defined in Part 4.1 as consumers who would "have no ability to use alternative energy sources, use natural gas primarily for space heating purposes, take relatively small volumes and have a high security requirement." Is this definition still appropriate and, if not, how should it be changed to be more relevant given current markets? Are the current exemption criteria as specified in Part 6 appropriate?

5) Utility Issues - As outlined in Part 5.1, utilities are required to maintain a portfolio of supply for core market customers that has sufficient characteristics of term, deliverability and supply security. Is this requirement still appropriate? If not, by what other means could prudent contracting practices be ensured?

Backgrounder

Natural Gas Core Market Policy Review

The 1988 British Columbia Core Market Policy established broad policy guidelines for key aspects of British Columbia's domestic natural gas supply, including the procurement of gas for core market customers by local distribution companies (LDCs) and the eligibility of utility customers for direct purchases of gas from producers. The B.C. Utilities Commission (BCUC) implemented the Policy through its Energy Supply Contract Rules (BCUC, October 18, 1990). The Policy provided a stable and effective framework during a period of rapid deregulation. The subsequent evolution of natural gas markets makes a review of the Policy and the BCUC Rules necessary to ensure that the supply security and pricing needs of consumers in the province are being adequately served.

The existing Policy has the objectives of ensuring a long-term secure supply of natural gas at reasonable prices to core market customers and providing sufficient incentives to businesses to locate in British Columbia. To this end, the Policy defines a core market and non-core market of natural gas consumers and principles to govern their respective gas supply arrangements.

The core market is defined as those customers who are unable to use alternative energy sources, use natural gas primarily for space heating, take relatively small volumes and have high security requirements. Core market customers can become eligible for direct sales only when they are able to demonstrate to the satisfaction of the BCUC that their proposed direct supply arrangements are sufficient to meet their greater security requirements. For the most part, the non-core market is comprised of large industrial customers, as few traditional core market customers have been allowed to buy gas directly.

The review of the Policy is prompted by changes in North American natural gas markets which have resulted in more flexible and innovative gas contracting practices. These changes include:

- Buyers and sellers being more willing to arrange supply through a mixed portfolio of spot, short-term and long-term gas contracts.

- Improved knowledge of the resource base leading many buyers to put less emphasis on long-term contracts.

- Traditional core market customers expressing greater interest in purchasing gas directly.

The BCUC is planning to hold a public review of its Rules in the Fall of 1992.